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September 16, 1994

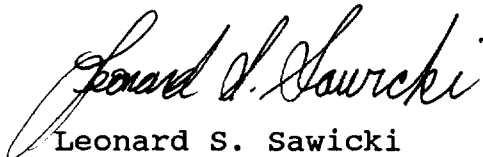
Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street NW
Washington, D.C. 20554

Re: CC Docket 94-1; Price Cap Performance Review for
Local Exchange Carriers

Dear Mr. Caton:

Today, Elizabeth Dickerson, Chris Frentrop and I met with Alex Belinfante, Anthony Bush, Dan Grosh, David Nall and Mark Uretsky of the Common Carrier Bureau. The purpose of the meeting was to review MCI's position in this proceeding. The attached information was used during the meeting and the specific topics discussed are listed there.

Sincerely,



Leonard S. Sawicki

Attachment

cc: Mr. Belinfante
Mr. Bush
Mr. Grosh
Mr. Nall
Mr. Uretsky

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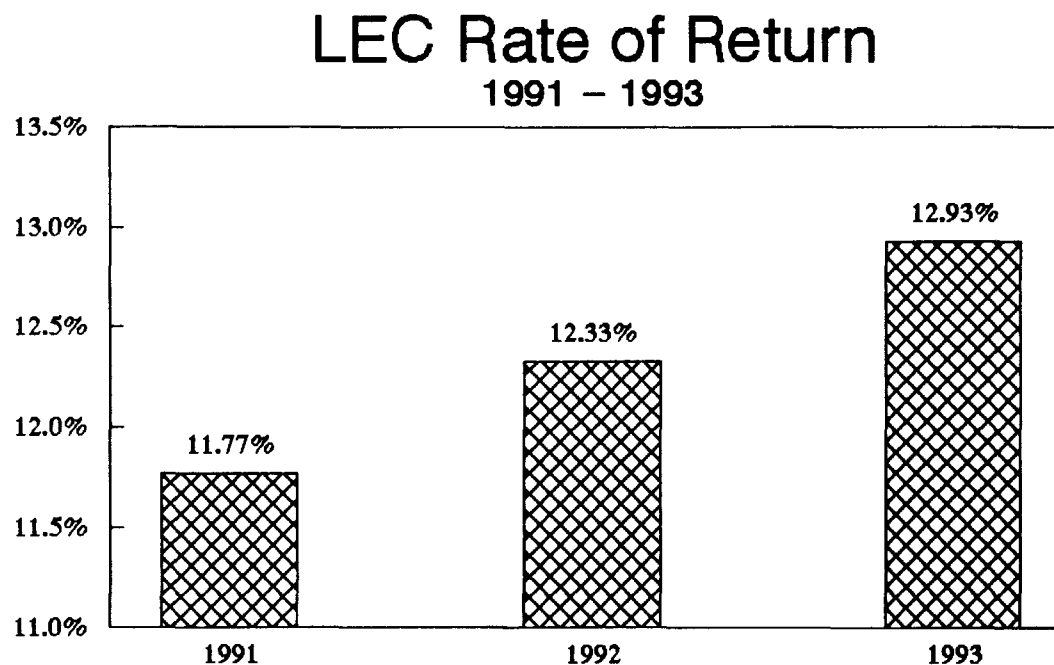
PRODUCTIVITY

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- Productivity factor should be increased
- Commission's original X was a "conservative minimum figure"

PRODUCTIVITY (cont'd.)

- LEC earnings have consistently risen under price caps

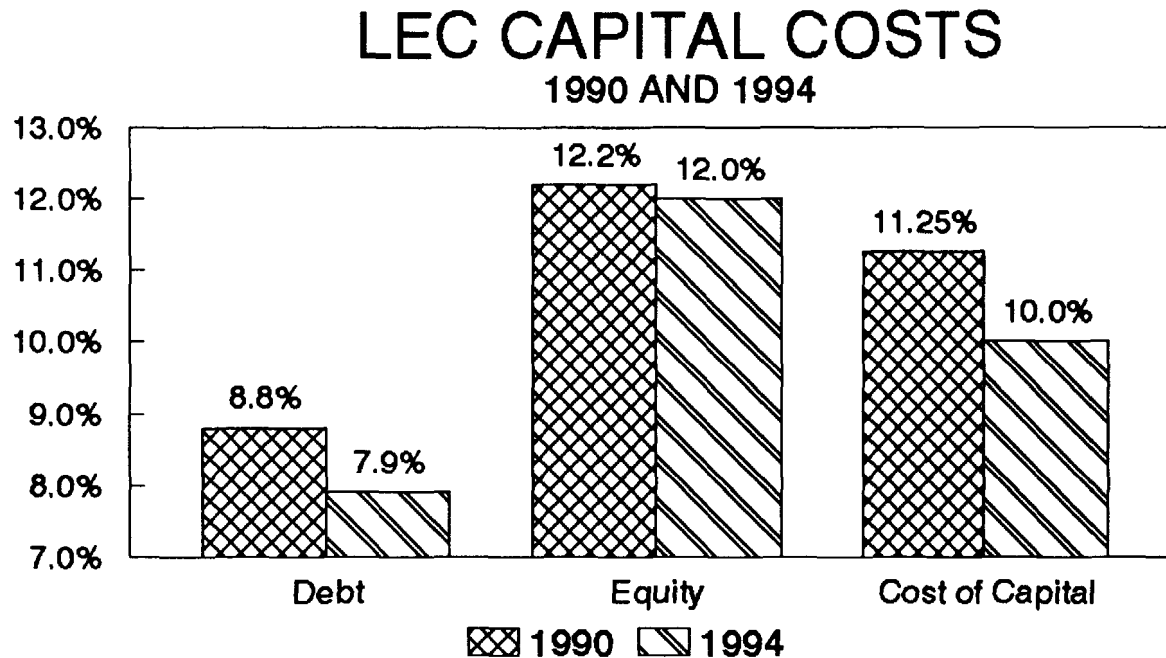


PRODUCTIVITY (cont'd.)

- An X of 5.9% would be consistent with both the original short-term study and the LECs' performance under price caps
- New services will increase LEC productivity possibilities

RATE OF RETURN

- Cost of capital has declined since 1990
- Updating the Commission's 1990 methodology with data through July 1994, the current cost of capital is 10 percent



RATE OF RETURN (cont'd.)

- Rate of Return changes are not captured in GNPPI – X, because X was set based on studies which held the rate of return constant
- In a competitive industry, firms do not keep reduced costs of capital forever; eventually they must pass through those reduced costs into lower prices

SHARING

- **Sharing Should Be Maintained**
 - Without sharing, the Commission lacks any meaningful enforcement mechanism
- **The Lower Adjustment Mechanism Is Extraneous**
 - LECs can petition for above-cap filings

SHARING (cont'd)

- Sharing Levels Should Be Reset to Reflect the Current Cost of Capital
- LEC Booking of Large Fourth Quarter Expenses Should Be Curtailed

EXOGENOUS TREATMENT

- LECs' Efforts to Expand Exogenous Treatment Have:
 - Eroded efficiency incentive
 - Been one-sided
 - Increased Administrative cost of Price Cap Regulation
- Commission Should Adopt New Theory:
 - Accord exogenous treatment only to Commission ordered rule changes that shift the allocation of costs between regulated and non-regulated operations or between the interstate and intrastate jurisdictions

EXOGENOUS TREATMENT (cont'd)

- Under New Theory Eliminate:
 - Inside Wire Amortization
 - Depreciation Reserve Deficiency Amortization
 - Transitional Support Fund
 - Taxes
 - "Other"
- Under New Theory Add:
 - Sales of exchanges to non-price cap LECs
 - Expiration of Equal Access Amortization

EXOGENOUS TREATMENT (cont'd)

- There Must Be a Formal Process to Reflect Decreases in Exogenous Costs
- Waiver Process Remains an Alternative for Costs that Pose Undue Burden.